

BUDGET LETTER

SUBJECT: 2005-06 BUDGET POLICY	NUMBER: 04-17 DATE ISSUED: July 28, 2004
REFERENCES:	SUPERSEDES: BL 03-18

TO: Agency Secretaries
Department Directors
Departmental Budget Officers
Departmental Accounting Officers
Department of Finance Budget Staff

FROM: DEPARTMENT OF FINANCE

Economic Recovery Workout Plan

When Governor Schwarzenegger took office, the State of California had accumulated an inherited debt of more than \$22 billion, representing policy and budgetary decisions made by the Legislature and the prior Administration. In the absence of corrective actions to change these policies, the State would have incurred annual operating deficits, estimated at \$14 billion in fiscal year 2004-05 and \$16.5 billion for 2005-06.

In response to such massive and growing debt, the Governor proposed a four-part economic recovery plan.

- In March, the voters approved Proposition 57—the Economic Recovery Bond Act—to refinance a portion of the inherited debt.
- In March, the voters also approved Proposition 58—a constitutional amendment to require balanced budgets with prudent reserves in the future.
- In April, the Legislature passed and the Governor signed a comprehensive reform of the State's workers' compensation system, which is the first step in the Governor's plan to improve the business and jobs climate in order to revitalize the State's economy and improve revenue growth over time.
- The May Revision proposed a budget for 2004-05 that moves toward structural balance. While a final budget for 2004-05 has not yet been adopted, we expect it to make significant progress toward structural balance in the next two years. Nonetheless, we must continue to reform expenditures in order to achieve the Governor's goal.

Significant Progress Toward Structural Balance

The Governor's Budget proposed a measured, long-term approach to put the State on the path to eliminate the State's operating deficit. Two key elements in this approach are: (1) to use one-time revenues only for one-time expenditures (in order to avoid increasing the operating deficits in future years) and (2) implementation of structural reforms that will have their greatest impact in the future. Examples of longer term reforms are Strategic Sourcing, Parole Accountability Reform, and Medi-Cal Reform, all of which should produce major savings beginning in 2005-06.

When the Governor unveiled the May Revision, he made it clear that he fully expected that the State would have to continue to reform expenditures for several years in order to avoid deficits. Accordingly, agencies and departments should prepare expenditure reduction plans consistent with the Governor's work-out plan. In developing these reduction proposals, agencies should continue to propose reforms to current programs including those not ultimately adopted in the 2004-05 budget. Agencies should carefully consider incorporating ideas included in the California Performance Review.

Under these circumstances, agencies should refrain from bringing forward any proposals to expand government. Any unavoidable General Fund cost proposals should be accompanied by offsetting savings proposals.

Detailed instructions will be issued later to formalize the reduction plan submission process.

Proposed Statutory Changes

Pursuant to Government Code Section 13308, Finance must provide to the Legislature on or before February 1 of each year, all proposed statutory changes, as prepared by the Legislative Counsel, necessary to implement the Governor's Budget. Therefore, all Budget Change or Reduction Proposals that require statutory changes also must include a copy of the proposed legislation. Finance will submit the approved language to the Legislative Counsel.

Comprehensive Budget Development Process

The Government Code and Budget Act require the Governor's Budget development process to be as comprehensive as possible, and any subsequent adjustments may only be made to meet critical and unanticipated needs. Further, the January Budget is to include all policy proposals being made for the ensuing fiscal year. Spring Finance Letters, due to the Legislature no later than April 1, should be used only for: (a) updating those proposals made in January or (b) submitting any new critical proposals that cannot be delayed until the upcoming fall budget process without serious consequences. The May Revision changes to the Governor's Budget are due to the Legislature no later than May 14 and will encompass only traditional enrollment, caseload, and population adjustments and any necessary budget balancing proposals. In you have any questions, please contact your Finance budget analyst.

/s/ DONNA ARDUIN

DONNA ARDUIN
Director